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Supreme Court of the United States.

OCTOBER TERM, 1965.

No.

JOHN B. JANIGAN,
Petitioner,

v.

FREDERICK B. TAYLOR ET AL.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

Petitioner, John B. Janigan, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit entered in the above-entitled case on May 4, 1965.

Opinions Below.

The first opinion of the District Court, holding petitioner liable, is reported at 212 F. Supp. 794, and is reprinted in the Record Appendix (hereinafter called "RA") at page 848, and its second opinion, assessing damages, is reported at 230 F. Supp. 858, and is reprinted at RA 862. The opinion of the Court of Appeals is reported at 344 F. 2d 781, and is reprinted in Appendix B hereto, *infra*, p. 30.

Jurisdiction.

The judgment of the Court of Appeals was entered on May 4, 1965. The jurisdiction of this Court is invoked under 62 Stat. 928, 28 U.S.C. § 1254 (1).

Questions Presented.

1. In an action brought under Section 10(b) of the Securities Exchange Act of 1934 by selling stockholders, including all of the corporate directors who were stockholders, is the running of the applicable state statute of limitations tolled by any so-called federal equitable doctrine until the fraud upon which the action is based is or should have been discovered even though it admittedly would not be tolled under state laws?

2. May the District Court make a finding of fact with respect to the petitioner's knowledge of facts in issue in the case on the basis of the Court's disbelief of the petitioner's denial of such knowledge?

3. In view of the requirements of Rule 52 of the Federal Rules of Civil Procedure, may the petitioner be found liable of having committed fraud in connection with his purchase of securities if the District Court did not find that the respondents relied on the only alleged misstatement made by the petitioner and may the Court of Appeals on the basis of its own search of the record conclude that a finding of reliance would have been warranted and supply the finding not made by the District Court?

4. May the petitioner be found liable of having committed fraud in connection with his purchase of securities where the alleged fraud consisted of one statement made by the petitioner after the persons to whom the offer to purchase was presented had voted that the offer was fair and all but one of such persons had agreed to sell him their stock?

5. May liability in an action of fraud under Section 10(b) of the Securities Exchange Act of 1934 in connection with the purchase of stock be based on a statement which is claimed to be false because it allegedly misstated facts which were readily available to the sellers of the stock?

6. May liability in an action of fraud arising under Section 10(b) of the Securities Exchange Act of 1934 in connection with the purchase of shares of stock be based on a statement which is alleged to be misleading in that it allegedly misrepresented the future prospects of the corporation whose stock was purchased?

7. May damages in an action of fraud under Section 10(b) of the Securities Exchange Act of 1934 be based on a theory of restitution rather than on the usual rule that damages are measured by the difference between the value of what is given up and of what is received?

Statutes and Rules Involved.

The statutory provisions involved are Section 10(b) of the Securities Exchange Act of 1934 (48 Stat. 891, 15 U.S.C. § 78j), Section 18 of the same Act (48 Stat. 897, as amended by 49 Stat. 1379, 15 U.S.C. § 78r), Section 28 of the same Act (48 Stat. 903, 15 U.S.C. § 78bb), Rule 52(a) of the Federal Rules of Civil Procedure (28 U.S.C. Rule 52(a)) and G.L. (Ter. Ed.) c. 260, §§ 2A and 12. Rule 10b-5 (17 C.F.R. § 240, 10b-5) is also involved.

These statutes and rules are printed in Appendix A hereto.

Statement of the Case.

This is an action of fraud, arising under Section 10(b) of the Securities Exchange Act of 1934 (48 Stat. 891, 15 U.S.C.

§ 78j) and Rule 10b-5 (17 C.F.R. 240, 10b-5) promulgated by the Securities and Exchange Commission, brought by the respondents, who alleged, in their amended complaint, that the petitioner, in connection with the purchase by him of all of the shares of common stock of Boston Electro Steel Casting, Inc. (hereinafter called "Besco"), "made statements of material fact that were untrue, omitted to state facts that were necessary to render the statements made, in the light of the circumstances, not misleading, and engaged in various acts which operated as a fraud and deceit upon the stockholders of" Besco.

Besco was a Massachusetts corporation engaged, in an old, if not obsolete, plant (RA 77), in the business of manufacturing and selling steel castings, which were made only upon receipt of orders from its customers (RA 74). All products were made from moulds belonging to the customers, and Besco manufactured no proprietary products (RA 74).

In 1952, following a dispute among Besco's directors, its stockholders voted to terminate the services of its general manager (RA 187). In April, 1952, Besco hired the petitioner, who was trained as an accountant and was a graduate of Harvard Business School, to be its general manager (RA 187-188). The petitioner was also elected a director and president of Besco (RA 74, 75). However, until the completion of the transaction which is the basis of this action, he owned none of its stock.

Prior to his purchase of the stock, the petitioner devoted himself exclusively and energetically to the management of the company. He worked long days and full weeks, supervised all of the company affairs and drastically reduced costs and overhead (RA 849; 212 F. Supp. 794, 795). The fiscal years ended September 30 of 1952, 1953 and 1954, respectively, were profitable, but in the fiscal year ended September 30, 1955, Besco operated at a loss. The sales

and operating results of each of those years and of the two years following petitioner's purchase of the Besco stock were as follows (RA 1255):

Fiscal Year	Sales	Profit or (Loss)
1952	$1,019,230.00	$29,382.00
1953	852,384.00	50,524.00
1954	647,844.00	18,279.00
1955	478,857.00	(15,453.00)
1956	824,850.00	95,694.00
1957	993,900.00	376,823.00

The results for 1955 were especially disappointing to the directors of the company because they occurred during a period of generally excellent economic conditions (RA 874).

In October and November of 1955 Besco sustained losses of $6,289.00 and $3,399.00, respectively (RA 938). Besco's books recorded a loss for December, 1955. However, the District Court found that some of the sales which were recorded in the operations of January, 1956, should have been recorded with those of December, 1955, and that, if this had been done, operations for December, 1955, would have resulted in a profit of $3,400.00 (RA 859; 212 F. Supp. 794, 800).

Beginning in March, 1953, Besco's directors had frequently discussed the desirability of selling or liquidating the company (RA 221-222). On October 5, 1955, before the certified audit report for the fiscal year ended September 30, 1955, was available (RA 974), the directors voted to call a special meeting of the stockholders "to take action with regard to sale or liquidation of the company" (RA 878). Petitioner opposed this action because Besco's losses did not exceed its depreciation, and therefore the company's quick assets were not being diminished (RA 878).

Two stockholders' meetings were held (RA 827). At the second meeting, held on December 17, 1955, the stockholders unanimously authorized the directors to enter into negotiations for a sale of all or any part of the company's assets, for a sale of its common stock, or for a merger, and instructed the directors to report back to the stockholders by March 15, 1956 (RA 219-220).

After the stockholders' meeting the petitioner informed the other directors that he wished to make an offer to purchase the stock of the company. At a special meeting of the directors held on December 27, 1955, he offered to purchase the common stock for $20.00 per share, provided he could acquire at least 90% of the outstanding shares (RA 872). The price of $20.00 per share offered by the petitioner for approximately 2,000 shares compared with an estimate, given by one of the stockholders, a professor at the Harvard Business School (RA 744), in November, 1955, that in liquidation they would not realize more than $29,000.00 and might realize nothing (RA 728-729). Despite almost continuous efforts since 1953 to find a buyer for Besco, no offer was made for the company by anyone other than petitioner.

After he made his offer, the petitioner retired from the meeting while the other directors discussed it (RA 873). However, he was present when the directors voted unanimously (the petitioner abstaining) that his offer was fair and a majority of the directors present who were stockholders indicated that they would tender their shares to him (RA 873).

After the vote was taken and the indications of tender were made, one of the directors, Mr. Bergen, asked whether the petitioner "knew of any material change in the affairs of the company or in the past months, which could cause us to have any different opinion about the company" (RA 733-734), to which petitioner replied: "There was none,

it was about the same" (RA 854-855; 212 F. Supp. 794, 798). Petitioner's liability is based on this statement (RA 856-857; 212 F. Supp. 794, 799).

The directors who acted on the petitioner's offer were all experienced in business affairs and in the affairs of Besco. They were Louis C. Farley, a vice-president of State Street Bank & Trust Company (RA 72); Ernest P. Neumann, a business man and former member of the faculty of the Massachusetts Institute of Technology (RA 703-704); Frederick B. Taylor, an executive of C. H. Sprague & Sons Company and chairman of the board of Besco (RA 186); Kenneth W. Bergen, an attorney (RA 692); and Elliott V. Grabill, an attorney (RA 754). All but Mr. Neumann, who was not a stockholder, are respondents in this case.

From the time that the directors were informed that petitioner intended to offer to purchase the stock of Besco, no inquiry regarding the condition of Besco's business was asked of petitioner until after the directors' vote. Although the directors had held meetings nearly every month and received monthly financial statements prepared by petitioner, the accuracy of which was not questioned, when the time came to sell the business they did not ask petitioner about the specific matters which, although known to them because of their positions as directors of Besco, became important to them only after the business was resold by the petitioner at a profit.

The petitioner purchased 1,876 shares of Besco common stock for $20.00 per share on January 10 or 11, 1956 (RA 735). Thereafter he purchased three small blocks of the stock, one at $20.00 per share, one at $5.00 per share (RA 614) and one at $50.00 per share.

After petitioner's purchase of the stock of Besco, it began to earn profits which were substantially higher than those earned while petitioner managed the company for

respondents. This turn of affairs was, as the Court of Appeals agreed, unforeseeable in December of 1955 (344 F. 2d 781, 785). In August, 1955, the company had put into effect a 10 per cent price increase (RA 879). In March and September of 1956 two additional price increases of 10 per cent each were made effective (RA 570-571). Besco's position in the industry was such that it could not have made these price increases unless other companies, which were price leaders, had previously done so, and the two increases of 1956 were not foreseeable in December, 1955 (RA 838). In January, 1956, while petitioner's offer was pending, Besco's plant superintendent, who in three years of service had increased the plant's efficiency, resigned. His successor, chosen by petitioner, had no experience in operating a foundry. Under petitioner's tutelage the new superintendent increased plant efficiency, as measured by the percentage of rejected castings and by the percentage of yield, substantially. Also during this period sales increased almost to the level of the period of 1952-1953. As a result of all these factors Besco earned substantial and unprecedented profits in 1956 and 1957, as is shown on the table on page 5 above (RA 1255). Certainly there was nothing in petitioner's prior experience with the company to lead him to believe that sales of $993,900.00 could yield profits of $376,823.00 when in fiscal 1952 sales of $1,019,230.00 had resulted in profits of only $29,382.00 and in fiscal 1953 sales of $852,384.00 had resulted in profits of only $50,524.00.

In 1957, petitioner, while seeking to buy another business, was persuaded to sell Besco (RA 821). The petitioner stated he would be willing to sell it for $600,000.00, but the broker whom he consulted suggested that he ask $700,000.00 in anticipation of bargaining (RA 821). Besco was sold for $700,000.00 (RA 747).

When he agreed to sell Besco, the petitioner called Mr. Bergen, an attorney who was a former stockholder and director of Besco and who is one of the respondents in this case, told him of the sale and the price, and asked Mr. Bergen to represent him in connection with the sale (RA 747). Eventually Mr. Bergen declined to represent the petitioner and informed the other respondents of what petitioner had told him, and subsequently this action was brought, on October 27, 1958, more than two years after respondents sold their stock to petitioner. The information on the basis of which the action was brought was obtained from petitioner, who made freely available to respondents whatever information they wanted (RA 747-748).

The District Court found for the respondents (RA 848; 212 F. Supp. 794) and awarded them damages of $514,054.00 (RA 862; 230 F. Supp. 858). The petitioner appealed to the Court of Appeals for the First Circuit, which, after directing the District Court to reduce the judgment by $41,567.00, affirmed the judgment as so modified.

The District Court held that, when petitioner answered Mr. Bergen's question, he failed to disclose material facts which he knew about Besco's business and that these facts indicated that Besco's business was at that time in the process of changing "into a condition of then unrealized but potentially large and immediate profit, prices in the industry having firmed and business on hand having doubled in the last three months and quintupled in the past year" (RA 857; 212 F. Supp. 794, 799). The District Court based this conclusion on its subsidiary findings that (1) sales had increased, (2) backlog had increased, and (3) prices were firmer.

On appeal petitioner argued that the increases in sales were made known by him to the respondents through the monthly profit and loss statements which he prepared and furnished to the directors; that Besco did not maintain

statistics on backlog and that he did not know that backlog had increased; and that he had promptly informed the directors of the 10 per cent price increase of August, 1955. He also argued that the information which he is alleged to have withheld was readily available to those of the respondents who were directors (the only respondents with whom he communicated) and that liability in a case of fraud under Rule 10b-5 cannot be based on the failure to disclose information which was readily available to the respondents, who were well informed about business matters and about the affairs of the company whose stock they were selling. He argued further that his answer to Mr. Bergen was true, because, if Besco was then experiencing a fluctuation in its business, the fluctuation, to the extent it was then apparent, was well within the limits of the company's prior experience, so that there was nothing to indicate that the company was on the verge of experiencing unusual profits. He also argued that the District Court found his answer inaccurate because he failed to tell the respondents that the business would become profitable, and that liability for fraud under the Securities Exchange Act of 1934 cannot be based on a failure to make a prediction concerning the future prospects of a business.

Reasons for Granting the Writ.

There are several reasons for granting the writ. The decision below conflicts with those of the Second and Seventh Circuits with regard to the standard of conduct imposed by Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 on persons buying and selling securities, and thus raises important questions about the interpretation of the Act. The decision below is contrary to decisions of this Court and in conflict with decisions of the

Tenth Circuit and ignores the provisions of Section 28 of the Securities Exchange Act of 1934 by holding that damages in a fraud action may be awarded on the theory of restitution rather than on the basis of the respondent's out-of-pocket loss. The decision below raises an important question concerning the application of a state statute of limitations to a federally created action at law and concerning the policy of Congress with regard thereto as expressed in Section 18 of the Securities Exchange Act of 1934. The decision below also raises important questions about the meaning and application of Rule 52 of the Federal Rules of Civil Procedure.

Summary of Argument.

The argument is divided into five parts. Part I argues that the opinion of the Court of Appeals raises important issues under Rule 52(a) of the Federal Rules of Civil Procedure because the Court of Appeals erroneously made a finding of fact which had been omitted by the District Court and because it upheld a finding of fact on grounds other than those given by the District Court for the finding and thus failed to give significance to the fact that the finding was plainly erroneous because it was expressly based on an incorrect view of the law. Part II argues that improper standards were applied in determining whether there was reliance, since the alleged misrepresentation was indisputably made after the respondents to whom the statement was made had manifested their acceptance of his offer. Part III argues that the Court of Appeals failed to give proper consideration to the decisions of this Court and to Congressional policy in holding that the statute of limitations was tolled. Part IV argues that there is a conflict between the decision in this case and decisions of the Second and Seventh Circuits with respect to the standards of

conduct commanded by Section 10(b) of the Securities Exchange Act of 1934. Part V argues that the opinion below conflicts with Section 28(a) of the Securities Exchange Act of 1934 and with decisions of this Court and of the Tenth Circuit because it holds that damages in this action based on fraud shall be based on restitution rather than on the federal out-of-pocket rule.

Argument.

I.

The opinion of the Court of Appeals raises important questions concerning the meaning and application of Rule 52(a) of the Federal Rules of Civil Procedure since the Court of Appeals made findings of fact on an essential issue on which the District Court made no finding, and on another issue disregarded the reason given by the District Court for one of its findings of fact.

This being an action based on an alleged fraudulent misstatement of fact, it was necessary for the respondents to establish that they relied on the misstatement. *List* v. *Fashion Park, Inc.*, 340 F. 2d 457 (2 Cir. 1965).

The District Court failed to find that the respondents relied on the petitioner's alleged misstatement. The Court of Appeals said with respect to this:

> "It is quite true that the court made no finding of reliance *in haec verba*. However, it stated in one portion of its opinion that over the years the directors reposed 'trust and confidence' in what defendant told them about the company and did so 'in the latter half of 1956 and early 1957.' (sic) It further found that it was 'elementary economics that information as to an increase in probable sales in any going business is information that is relevant and material to any poten-

> tial buyer,' and that the defendant 'knowingly failed to disclose . . . material facts to the Board because their concealment had a tendency to bring about the acceptance by the Board of the offer which he had just submitted.' We think it fairly and adequately implicit in the court's findings, in toto, that it found reliance upon the representation.'" 344 F. 2d 781, 786.

In a footnote to the paragraph just quoted the Court of Appeals also said:

> "It must be conceded that the court said even less with respect to the plaintiffs who were not directors. However, the court did find that defendant's 'offer also was conditioned upon director-shareholders notifying all other shareholders that they themselves had accepted Janigan's offer and recommended its acceptance by all shareholders.'" *Ibid.*

We do not discuss the question of whether the subsidiary facts cited by the Court of Appeals would have supported a finding of reliance. No such finding was made, and under Rule 52(a) it was for the District Court, not the Court of Appeals, to make the essential findings. The conclusion of the Court of Appeals that such a finding was implicit is insufficient since it is the purpose of the Rule that the trial court make the necessary findings of fact. *United States* v. *Forness*, 125 F. 2d 928 (2 Cir. 1942). Moore's Federal Practice (2d Ed.), § 52.06 [1].

If the trial court has not made the necessary findings of fact, it is not the function of the appellate court to search the record for facts which will support the judgment. As this Court said in *Kelley* v. *Everglades Drainage District*, 319 U.S. 415, 421-422 (1943):

> "It may be that adequate evidence as to these matters is in the present record. On that we do not pass,

for it is not the function of this Court to search the record and analyze the evidence in order to supply findings which the trial court failed to make."

When the Court of Appeals undertook to supply the finding that the respondents relied on the petitioner's statement, it acted in a manner opposed to the purpose of Rule 52(a) and substituted fact-finding for appellate review.

One of the issues before the District Court was whether the petitioner had knowledge that Besco's prices had firmed and backlog increased in late 1955. The District Court found that he had such knowledge, in the following paragraph:

> "I find that Janigan was not a truthful witness either during the taking of his deposition or while testifying in Court. Specifically, I disbelieve his denials of knowledge of the firming of prices and increase in backlog in late 1955 and, *not believing his denials of such knowledge,* I find that he did know about them at the time he told Bergen that things were about the same. Cf. *National Labor Relations Board* v. *N. E. Webb, Inc. et al,* No. 5988, C.A. 1 Nov. 13, 1962 (Slip-sheet opinion); and *Labor Board* v. *Walton Mfg. Co.* 369 U. S. 404, 408 (1962), to the effect that 'the demeanor of a witness ". . . may satisfy the tribunal, not only that the witness' testimony is not true, but that the truth is the opposite of his story . . ."'" (Emphasis added.) (RA 858; 212 F. Supp. 794, 800.)

Relying on *Moore* v. *Chesapeake & Ohio Railway Co.*, 340 U.S. 573 (1951), and *Nishikawa* v. *Dulles,* 356 U.S. 129 (1958), the petitioner challenged this finding and argued to the Court of Appeals that a fact may not be found on the basis of the disbelief of a witness's denial of the fact. The

Court of Appeals did not disagree with the petitioner's statement of the law, but, notwithstanding the District Court's specific statement that, "not believing his denials of such knowledge," it found that petitioner had such knowledge, the Court of Appeals held that the District Court did not base its finding on its disbelief of the petitioner and on the erroneous view that the law permits a finding of fact to be made on the basis of such disbelief. The Court of Appeals said:

> "Whatever the arguable meaning of the court's language we do not think that it intended to adopt such a fallacy. Rather, we take its statement as a roundabout way of saying that the evidence of the material facts, and of defendant's access thereto and connection therewith, was such that it would infer full knowledge on defendant's part unless it believed his profession of ignorance, and that not so believing, this inference controlled. On this basis the sole question is the correctness of the underlying findings." 344 F. 2d 781, 785.

The interpretation which the Court of Appeals made of the language quoted from the District Court's opinion will not withstand analysis. The District Court explicitly based its finding of knowledge solely on its disbelief of the petitioner. Its quotation from *National Labor Relations Board* v. *Walton Manufacturing Co.*, 369 U.S. 404 (1962), clearly shows that it was of the opinion that it could base its finding of fact on such disbelief. Nowhere in the District Court's opinion can one find a reference to "underlying findings" as support for its finding that the petitioner had the knowledge referred to. The paragraph quoted above from its opinion is the only place where it discussed the petitioner's knowledge of firming of prices and increase in backlog.

By so interpreting the District Court's opinion that its plain meaning was ignored, the Court of Appeals not only permitted a finding of fact, made on the basis of a view of the law which conflicts with that expressed by this Court in the *Moore* and *Nishikawa* cases, cited above, to stand, but it also acted contrary to the spirit and intent of the Federal Rules of Civil Procedure.

Rule 52(a) requires that the District Court "shall find the facts specially and state separately its conclusions of law." Such findings of fact are required in part as an aid to appellate courts. *Hurwitz* v. *Hurwitz,* 136 F. 2d 796 (C.A. D.C. 1943). However, the Rule will not serve that function if, as in the instant case, the Court of Appeals improperly undertakes to search the record for other facts to support a finding of fact which was improperly made. *Kelley* v. *Everglades Drainage District,* 319 U.S. 415, 421 (1943). By undertaking to supply the factual support for the District Court's erroneous finding, the Court of Appeals substituted itself for the District Court as the fact-finding body and, in effect, relieved the District Court of the duty of making findings of fact which are not "clearly erroneous." At the same time it failed to perform its duty of setting aside a finding of fact which was clearly erroneous because it was based on an incorrect view of the law. *Davis* v. *Parkhill-Goodloe Co.,* 302 F. 2d 489 (5th Cir. 1962); *J. D. Hedin Construction Co., Inc.,* v. *F. S. Bowen Electric Co., Inc.,* 273 F. 2d 511 (C.A. D.C. 1960).

II.

The decision of the Court of Appeals raises an important question concerning the interpretation and application of Section 10(b) of the Securities Exchange Act of 1934 and by implication conflicts with a decision of the Second Circuit. Although the Court of Appeals acknowledged that

in a case arising under Section 10(b) of the Act it is necessary to show reliance on the alleged misrepresentation in order to establish liability (344 F. 2d 781, 787), it is clear that there could have been no reliance in this case unless in cases arising under Section 10(b) the meaning of reliance differs from its meaning elsewhere in the law.

Quoting the Restatement, Torts, § 546 (1938), the Second Circuit has explained that the test of reliance ". . . is whether 'the misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient's] loss.'" *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462 (2 Cir. 1965). "The reason for this requirement . . . is to certify that the conduct of the defendant actually caused the plaintiffs injury." *Ibid.*

It is undisputed that the petitioner's answer to Mr. Bergen's question came after the directors had voted that the petitioner's offer was fair and after all of the director-stockholders but Bergen had indicated their acceptance of the petitioner's offer. The only witness who testified concerning the time when the question was asked and answer given was the respondent Bergen. In response to questions put by his counsel, he testified: "I asked *at the end of the meeting* whether Mr. Janigan knew of any material change in the affairs of the company . . ." (RA 733-734). (Emphasis added.) "At the end of the meeting" obviously means after all other business had been transacted, so that the directors' unanimous vote that the offer was fair and the aceptance of the offer by all of the director-stockholders but Bergen (RA 873) took place before the alleged misstatement was uttered. It was physically impossible, on the basis of the respondent's own testimony, for that statement to have influenced the actions of the directors.

Except in the cases of three stockholders who did not sell their stock in response to the petitioner's offer as communicated to them by Bergen, the petitioner had no com-

munication with any stockholders who were not directors. He did communicate with the three referred to, and, while there is testimony of representations made by the petitioner to two of the three, the District Court made no findings concerning them.

Although this question was argued by petitioner in his brief to the Court of Appeals (see Brief for Appellant, pp. 60-62), that Court did not discuss this issue, and therefore we do not know what standards it applied. However, since it held that a finding of reliance by the District Court was to be implied and it affirmed the judgment of the District Court as modified, we can conclude only that under its view of the law reliance can be found even if the alleged misstatement was made after the plaintiff has acted. Not only is this a novel view of the law which should be reviewed by this Court, but it raises a conflict with the law as interpreted by the Second Circuit.

The decision of the Court of Appeals also raises the question of whether reliance could be found where the information alleged to have been omitted was readily available to the people to whom the alleged misstatement was made. The people with whom petitioner met on December 27, 1955, were, after all, Besco's directors. They had held meetings nearly every month and had received monthly financial statements. As directors they exercised all of the powers of the corporation (G.L. (Ter. Ed.) c. 156, § 25), and petitioner, as president, was subordinate to them. *Horowitz* v. *State Street Trust Co.*, 283 Mass. 53, 58 (1933). All information concerning the corporation was available to them as a matter of law, and they had exercised their prerogative to obtain information independently of petitioner (RA 881). In these circumstances the decision of the Court of Appeals, which gave no consideration to the availability of information to the directors and which based liability on a general question which asked for no specific

information, seems based on an unduly harsh and narrow interpretation of the statute.

III.

This case raises an important unanswered question concerning the application of a state statute of limitations to a federal cause of action.

The Securities Exchange Act of 1934 contains no provision for limitation of actions applicable to an action arising under Section 10(b). Therefore the state statute applies. *Campbell* v. *Haverhill,* 155 U.S. 610 (1895). The Massachusetts statute provides a two-year period (G.L. c. 260, § 2A). "More than two years had elapsed since the representation and sale before the present suit was brought." *Janigan* v. *Taylor,* 344 F. 2d 781, 783. Moreover, the statute of limitations was not tolled by the provisions of G.L. (Ter. Ed.) c. 260, § 12, or by any other principles of Massachusetts law. *Janigan* v. *Taylor, Ibid.*

Nevertheless, the Court of Appeals held that the statute of limitations was tolled by virtue of the presumed federal principle that the statute does not begin to run until the fraud is, or should have been, discovered by the party suing. In so holding, the Court of Appeals extended to an action of law the doctrine which has been applied by this Court only in equity cases.

This Court has held that, where a case concerns a federally created right for which the sole remedy is in equity, the equitable doctrine of laches will apply and reference will be made to the state statute of limitations only as a guide. In such cases the federal doctrine that fraud tolls the statute of limitations in determining the effect to be given to the statute will be applied. *Holmberg* v. *Armbrecht,* 327 U.S. 392 (1946). However, if "the jurisdiction of the federal court [in equity] is concurrent with that

at law, or the suit is brought in aid of a legal right, *equity will withhold its remedy if the legal right is barred by the local statute of limitations.*" (Emphasis added.) *Russell* v. *Todd*, 309 U.S. 280, 289 (1940). And this Court said later:

> "Even though these suits are in equity, the states' statutes of limitations apply. For it is only the scope of the relief sought and the multitude of parties sued which give equity concurrent jurisdiction to enforce the legal obligation here asserted. *And equity will withhold its relief in such a case where the applicable statute of limitations would bar the concurrent legal remedy.*" (Emphasis added.) *Cope* v. *Anderson*, 331 U.S. 461, 463-464 (1947).

This action sounds in tort for deceit (*Fratt* v. *Robinson*, 203 F. 2d 627 (9 Cir. 1953)), an action at law. Not only have the decisions of this Court not applied the federal equity doctrine to state statutes of limitation, but the implication of *Russell* v. *Todd* and *Cope* v. *Anderson* is that, where the right to be enforced is a legal right, the federal equity doctrine is not to be applied.

Moreover, the federal equity doctrine is at odds with the policy of the Securities Exchange Act of 1934. Section 18(a) of the Act creates a cause of action based on false or misleading statements contained in registration statements. However, such an action must be brought within one year after the discovery of facts constituting the cause of action, but not more than three years after such cause of action accrues (48 Stat. 897, 15 U.S.C. § 78r). Similar provisions are contained in the Securities Act of 1933, 48 Stat. 84, as amended by 48 Stat. 908, 15 U.S.C. § 77m, and the Public Utility Holding Company Act of 1935, 49 Stat. 829, 15 U.S.C. § 79p.

Therefore the decision of the Court of Appeals extends the decisions of this Court beyond their limits and is contrary to the policy expressed by Congress. It raises an important question about the meaning of this Court's earlier decisions and about the statute of limitations applicable to cases arising under Section 10(b) of the Act.

IV.

The decision of the Court below conflicts with those of the Second and Seventh Circuits with respect to the standards of conduct imposed by Section 10(b) of the Act and Rule 10b-5.

Because the opinion of the Court below contains no discussion of the principles of law which that Court considered pertinent in reaching its decision, the conflict referred to cannot be established by quoting what it said. Nevertheless, the conflict becomes apparent from the Court's selection from, and discussion of, the facts found by the District Court.

The portion of the opinion of the Court below dealing with liability consisted of a discussion of such of the facts found by the District Court as the Court of Appeals considered important. The Court of Appeals indicated what it thought was the importance of these facts by saying: "Essentially the representation was false because there had been a firming of prices and an increasing backlog of orders such that *the first quarter of 1956 could be expected* by defendant, due to his detailed knowledge, to show a profit." (Emphasis added.) 344 F. 2d 781, 785.

The Court of Appeals was charging the petitioner with having failed to indicate to the respondents that the first quarter following the sale of their stock to the petitioner would be profitable.

The Court returned to this concern for the future when it said:

> "Viewed against a background of past fluctuations, we might not find the misrepresentation to be of the importance intimated by the court's opinion. Certainly it could not be claimed that the change presaged the dramatic improvement that occurred subsequently in the company's affairs, or that the defendant could have any thought that it did. On the other hand, even as a new upswing not uncharacteristic of the business, *plus some promising overtones*, we could not find that as a matter of law the true situation was fairly disclosed, within the heavy requirements of the Act, by the single statement that things were 'about the same.'" (Emphasis added.) 344 F. 2d 781, 785.

The Court's view that the petitioner had a responsibility to indicate to the respondents that he expected business to be better in the future is clear. In this respect the Court of Appeals was repeating the view of the District Court, which also found the allegedly undisclosed facts to be significant because they indicated to the District Court that the business of Besco on December 27, 1955, was potentially profitable (RA 857, 212 F. Supp. 794, 799).

Both the Second and the Seventh Circuits have held that facts which have only a speculative relationship to the future value of the security are not material. *List* v. *Fashion Park, Inc.*, 340 F. 2d 457 (2 Cir. 1965), pet'n for cert. filed *sub nom. List* v. *Lerner*, March 30, 1965 (no obligation to disclose possibility of sale or merger of company). *Kohler* v. *Kohler Co.*, 319 F. 2d 634 (7 Cir. 1963) (no obligation to furnish plaintiff with "guesswork" on future values of company based on comparison of its last completed fiscal year with incomplete financial data of competing companies). *James Blackstone Memorial Library Association* v. *Gulf, Mobile & Ohio Railroad Co.*, 264 F. 2d 445 (7 Cir. 1959), cert. den. 361 U.S. 815 (1959) (no obligation to in-

form plaintiffs of desire and hope to sell real estate at a profit).

Except under unusual circumstances such as obtained in *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951), where the realization of the profit awaited only the liquidation of the company, the earning of a profit in advance of the fact is a speculative matter. In this case the First Circuit found petitioner liable because he failed to indulge in "guesswork." The Second and Seventh Circuits have held that speculative matters are not material.

The men with whom the petitioner dealt when he made his offer were the directors of the company (RA 854; 212 F. Supp. 794, 798). They were men who were experienced in business and had been directors of this company for several years.

The First Circuit did not consider these facts in its discussion of the case. Apparently "the heavy requirements of the Act" remain the same in its view, whether the case is one involving an "insider" dealing with other "insiders" or an "insider" dealing with "outsiders."

Both the Second and the Seventh Circuits have held that, in determining whether an undisclosed fact is material, the knowledge and experience of the plaintiff are to be taken into account. In *List* v. *Fashion Park, Inc., supra,* the fact that the plaintiff was himself an experienced and successful investor in securities was taken into consideration by the Court. In *Kohler* v. *Kohler Co., supra,* the Court recognized and considered the fact that the plaintiff was not a novice to stock transactions and that he was a person who had had many years of intimate acquaintance with the affairs of the corporation.

By its failure to discuss whether in the light of their experience the directors would have been influenced by the facts allegedly not disclosed to them by the petitioner, the First Circuit seems to be imposing a standard of absolute

liability based on retrospective wisdom and to be establishing "a scheme of investors' insurance" not contemplated by the Act. See *List* v. *Fashion Park, Inc.*, 340 F. 2d 457. Although the purpose of Section 10(b) of the Act and Rule 10b-5 is to modify the doctrine of *caveat emptor* as between insiders and outsiders (*Kohler* v. *Kohler Co.*, 319 F. 2d 634 (7 Cir. 1963); *List* v. *Fashion Park, Inc., supra*), the First Circuit, in the case at bar, did not consider the fact that the petitioner's statement was made to insiders, corporate directors who by virtue of their position had available to them any information which they deemed pertinent. Both the Second and the Seventh Circuits have held that the experience and position of the plaintiff are pertinent in determining liability in a case under Section 10(b) of the Act. The Seventh Circuit has held that insiders "are not required to search out details that presumably would not influence the person's judgment with whom they are dealing." *Kohler* v. *Kohler Co., supra*, 642. In the same case the Seventh Circuit also held that an insider dealing with another insider who is familiar with the company is not held to the same standard as when he is dealing with an outsider, and he could anticipate that the seller would ask for such additional information as he deemed important.

The First Circuit failed to discuss the legal standards which it applied. It merely referred to "the heavy requirements of the Act" without stating what these requirements are. However, the effect of its opinion is to impose standards of absolute liability which do not take into account the factors which both the Second and the Seventh Circuits found important. In the First Circuit a misrepresentation of uncertain importance is sufficient to be the basis of liability regardless of the experience and knowledge of the persons to whom the statement is made. In the Second and the Seventh Circuits the identity of the plaintiff, his experience, his knowledge and his sources of

additional information are all considered in determining the materiality of the representation. Two separate standards of determining liability are developing. The proper interpretation of the Act requires that the conflict between the Circuits be resolved.

V.

The decision of the Court of Appeals affirmed the use of a measure of damages which conflicts with that stated in Section 28(a) of the Securities Exchange Act of 1934 and with the decisions relating to damages of this Court and of the Tenth Circuit.

The Court of Appeals held that, where property is sold to the fraudulent party, damages are to be assessed on the theory of restitution and that "future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative," are to be added to the damages. *Janigan* v. *Taylor,* 344 F. 2d 781, 786 (1st Cir. 1965). Therefore damages were assessed on the basis of the amount petitioner realized on the subsequent resale of Besco.

However, Section 28(a) of the Securities Exchange Act of 1934 (49 Stat. 903, 15 U.S.C. § 78bb) specifically provides that recovery for any violation of the Act shall not exceed an amount equal to "his actual damages on account of the act complained of." "Actual damages" under the federal rule means the difference between the value of what was given up and the value of what was received, and "does not include the expectant fruits of an unrealized speculation." *Estate Counseling Service, Inc.,* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F. 2d 527, 533 (10 Cir. 1962). *Kohler* v. *Kohler Co.,* 208 F. Supp. 808, 824 (E.D. Wis. 1962). *Speed* v. *Transamerica Corp.,* 135 F. Supp. 176, 179 (D. Del. 1955). *Kardon* v. *National Gypsum Co.,* 73 F. Supp. 798, 802 (E.D. Pa. 1947).

This Court anticipated and answered the argument of the First Circuit in *United States* v. *Bitter Root Development Co.*, 200 U.S. 451 (1906). In that case United States alleged that it had been defrauded by the defendant and sought an accounting of the profits realized by the defendant following its fraud. However, this Court denied the requested remedy and held that, in an action based on fraud, where there is an adequate remedy at law, the plaintiff's remedy is in damages.

By its decision the First Circuit has raised an important question concerning the meaning of damages under Section 28 of the Act, and a conflict with the Tenth Circuit has developed. The issue involved is important for the interpretation of this statute.

Conclusion.

For the reasons stated above, it is respectfully submitted that a writ of certiorari should issue to the United States Court of Appeals for the First Circuit so that the important questions relating to the Securities Exchange Act of 1934 and the Federal Rules of Civil Procedure may be heard on their merits.

Respectfully submitted,

MATTHEW BROWN,
JOSHUA A. GUBERMAN,
HAROLD LAVIEN.

Dated, Boston, Massachusetts,
July 29, 1965.

Appendix A.

Statutes and Rules Involved.

Section 10(b) of the Securities Act of 1934:

Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 18(c) of the Securities Act of 1934:

No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

Section 28(a) of the Securities Act of 1934:

The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual dam-

ages on account of the act complained of. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

Rule 52(a) of the Federal Rules of Civil Procedure:

Rule 52. Findings by the Court.

(a) EFFECT. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decison is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41 (b).

Mass. G.L. c. 260, § 2A:

Except as otherwise provided, actions of tort, actions of contract to recover for personal injuries, and actions of replevin, shall be commenced only within two years next after the cause of action accrues.

Mass. G.L. (Ter. Ed.) c. 260, § 12:

If a person liable to a personal action fraudulently conceals the cause of such action from the knowledge of the person entitled to bring it, the period prior to the discovery of his cause of action by the person so entitled shall be excluded in determining the time limited for the commencement of the action.

Rule 10b-5 of the Securities and Exchange Commission:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Appendix B.

United States Court of Appeals
For the First Circuit

No. 6410.

JOHN B. JANIGAN,
DEFENDANT, APPELLANT,
v.
FREDERICK B. TAYLOR ET AL.,
PLAINTIFFS, APPELLEES.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

[212 F.Supp. 794]
[230 F.Supp. 858]

Before ALDRICH, *Chief Judge*, SWEENEY, *Chief Judge* and WYZANSKI, *District Judge*.

Harold Lavien, with whom *Joshua A. Guberman* and *Brown, Rudnick, Freed & Gesmer* were on brief, for appellant.
Harold M. Willcox, with whom *Charles C. Cabot, Jr.*, was on brief, for appellees.

OPINION OF THE COURT.

May 4, 1965.

ALDRICH, *Chief Judge*. This is a personal action brought by plaintiffs as a class in the district court for the district of Massachusetts in which they allege violations by the defendant of Rule 10b-5 (17 C.F.R. §240, 10b-5) of the Securities and Exchange Commission promulgated pur-

suant to section 10 of the Securities Exchange Act of 1934 (15 U.S.C. §78j), hereinafter the Act. The cause of action arises by implication of the Act. *Fratt* v. *Robinson,* 9 Cir., 1953, 203 F. 2d 627, 631-33. The basic facts are simple. The plaintiffs are former stockholders, some of whom were also the controlling directors, of Boston Electro Steel Casting, Inc. (BESCO). For convenience they will be called stockholders, directors, or, collectively, plaintiffs. The defendant was the president, general manager and a director of BESCO. In early 1956, following a directors' meeting on December 27, 1955, defendant purchased plaintiffs' stock (virtually all of the outstanding stock of the company) for approximately $40,000. In December 1957 he sold it for $700,000. Suit was brought in October 1958. Plaintiffs' action rests upon a statement by the defendant admittedly made at the December 27 meeting in response to a question by one of the directors.[1] Asked whether he "knew of any material change in the affairs of the company or in the past months which could cause us to have any different opinion about the company," his answer was, "[T]here was none, it was about the same." For convenience we will call this the representation. Trial was had without jury. The district court found the representation consciously and materially false and, to the degree hereinafter set forth, that plaintiffs relied on it, and awarded as damages defendant's net profits. Defendant appeals. All events took place in Massachusetts and it is agreed that its law governs to the extent that federal law does not.

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[1] Plaintiffs have not contended, and we do not need to decide, that the Act imposes a general duty to make disclosures beyond and apart from disclosures needed to render entirely truthful all affirmative statements which have been made. For a comprehensive discussion see *List* v. *Fashion Park, Inc.,* 2 Cir., 1965, 340 F.2d 457, 461-62, *pet'n for cert. filed sub nom. List* v. *Lerner,* Mar. 30, 1965; *cf. Kohler* v. *Kohler Co.,* 7 Cir., 1963, 319 F.2d 634.

At the threshold is the question whether plaintiffs' action was brought too late. Although other sections of the Act have attached provisions for limitation of action, there is none here applicable. Hence the state statute applies. *Campbell* v. *Haverhill,* 1895, 155 U.S. 610. This is two years. Mass. G.L. c. 260 §2A. More than two years had elapsed since the representation and sale before the present suit was brought. In light of this, plaintiffs claim the benefit of Mass. G.L. c. 260 §12 under which the statute of limitations is tolled if the cause of action has been fraudulently concealed. The tolling statute, however, requires some affirmative act of concealment except, apparently, where there is a duty to disclose imposed by a fiduciary relationship. *Stetson* v. *French,* 1947, 321 Mass. 195, 198-200; *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow,* 1909, 203 Mass. 159, 201. The sole case which plaintiffs cite for the contrary position, *Brackett* v. *Perry,* 1909, 201 Mass. 502, in no way supports it.

Absent special circumstances, an officer or director has no fiduciary duties in purchasing or selling stock under Massachusetts law. *Goodwin* v. *Agassiz,* 1933, 283 Mass. 358, 361-3; *Gladstone* v. *Murray Co.,* 1943, 314 Mass. 584, 587. Nor has he at federal law. See *Strong* v. *Repide,* 1909, 213 U.S. 419, 431-3. Hence, unless we should decide that the effect of the Act is to establish new fiduciary relationships, fn. 1, *supra,* plaintiffs show nothing entitling them to the benefit of the Massachusetts tolling section under either the general rule or the exception.

It is unnecessary to interpret the Act in order to toll the statute of limitations. Federal law has long been established, with more liberality than that of Massachusetts, that where fraud is involved the cause of action is, so-to-speak, automatically concealed, and does not arise until discovery. *Bailey* v. *Glover,* 1875, 21 Wall. 342; *Traer* v. *Clews,* 1885, 115 U.S. 528. *Bailey* v. *Glover* was said to

apply equally to actions "at law" and "in equity" in tolling federal statutes of limitations. 21 Wall. at 349. *Holmberg* v. *Armbrecht,* 1946, 327 U.S. 392, extended the doctrine to toll a state statute of limitations where the cause of action was federal in origin and equitable. We are in considerable sympathy with Judge Friendly's opinion in *Moviecolor Ltd.* v. *Eastman Kodak Co.,* 2 Cir., 1961, 288 F.2d 80, *cert. den.* 368 U.S. 821, to the effect that the *Holmberg* decision should be applied to state statutes of limitation where the cause of action is federal in origin and cognizable solely in federal courts, whether the cause of action be regarded as "legal" or "equitable," concepts which have lost much of their meaning in federal practice. Without deciding how far we would carry this principle we hold that federal law must determine the date of accrual here even though the period of limitation thereafter is determined by state law.

Turning to the merits, the defendant makes a massive attack upon the court's findings that his representation was false, and that it was consciously so. We will deal first with the latter findings because defendant's criticism of one aspect of them has at least superficial merit. The court stated,

> "I find that Janigan was not a truthful witness either during the taking of his deposition or while testifying in Court. Specifically, I disbelieve his denials of knowledge of the firming of prices and increase of backlog in late 1955 and, not believing his denials of such knowledge, I find that he did know about them at the time he told Bergen that things were just about the same." 212 F.Supp. at 800.

Defendant argues that this was a violation of the principle that disbelief of testimony does not of itself constitute a basis for finding the opposite. Although the temptation

to do so may be strong, see *Dyer* v. *MacDougall,* 2 Cir., 1952, 201 F.2d 265, 269, however satisfied a court may be from the witness's demeanor or his demonstrated untruthfulness in other respects that certain testimony is false, it cannot use such disbelief alone to support a finding that the opposite was the fact. See *Moore* v. *Chesapeake & Ohio Railway Co.,* 1951, 340 U.S. 573, 576-7; *Nishikawa* v. *Dulles,* 1958, 356 U.S. 129, 137. The reason must be obvious. Were the rule otherwise a case could be made for any proposition in the world by the simple process of calling one's adversary and arguing to the jury that he was not to be believed.

Whatever the arguable meaning of the court's language we do not think that it intended to adopt such a fallacy. Rather, we take its statement as a roundabout way of saying that the evidence of the material facts, and of defendant's access thereto and connection therewith, was such that it would infer full knowledge on defendant's part unless it believed his profession of ignorance, and that not so believing, this inference controlled. On this basis the sole question is the correctness of the underlying findings.

The district court's considerable number of subsidiary findings, if well founded, warrant its conclusion that defendant's representation was materially false. In the main we find them supported by the evidence. The plaintiff became president and general manager of BESCO in April 1952. BESCO was a steel foundry doing, exclusively, a special order business. It was, accordingly, peculiarly dependent upon its customers and upon a steady influx of orders. In addition, its plant was old and relatively inefficient and its financial position poor. New capital was needed, and none was obtainable. Rather, the company was in trouble with an R.F.C. loan. The directors left the company's affairs almost exclusively to the defendant, and accepted the validity of his reports of current con-

ditions, which were generally pessimistic. However, we think the finding that they were "all" pessimistic is open to question. The indications in the court's opinion that the company sustained a loss every month were incorrect.[2] On the contrary, it is quite clear that the business measurably fluctuated.

In the fall of 1955 the directors called a stockholders meeting for the purpose of considering sale or liquidation. The defendant opposed the call of the meeting. It also seems clear that no misstatement by him, and no failure to disclose, brought about the meeting, or the decision reached that a sale should be attempted. This, however, is not determinative. The question is what happened thereafter. One month after the stockholders meeting the defendant made an offer himself and the representation in question. Essentially the representation was false because there had been a firming of prices and an increasing backlog of orders such that the first quarter of 1956 could be expected by defendant, due to his detailed knowledge, to show a profit. Furthermore, the court found various changes in practice with respect to pricing of inventory, and actual alterations to conceal an improvement in profits.[3]

Viewed against a background of past fluctuations, we might not find the misrepresentation to be of the importance intimated by the court's opinion. Certainly it could not be

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[2] For example, the court referred to "an apparent profit in May [1955] because certain bills incurred therein were deferred" to June, suggesting that the true May balance should have been a deficit. Actually, had these bills not been deferred there would have been a profit in both months, rather than in neither. On this basis the undisclosed profit in the fall of 1955 was of smaller overall significance in the sense of indicating a change.

[3] Defendant is correct that since the bookkeeping changes occurred only after the making of the representation, and were not seen by the plaintiffs, they could not have been relied on. However, they were admissible as casting light on the defendant's state of mind, and, very possibly, to affect his credibility.

claimed that the change presaged the dramatic improvement that occurred subsequently in the company's affairs, or that the defendant could have any thought that it did. On the other hand, even as a new upswing not uncharacteristic of the business, plus some promising overtones, we could not find that as a matter of law the true situation was fairly disclosed, within the heavy requirements of the Act, by the single statement that things were "about the same."

The defendant argues that the court made no finding that the plaintiffs relied upon defendant's representation. Under any interpretation of the Act this is a necessary condition. *List* v. *Fashion Park, Inc., supra,* fn. 1, 340 F.2d at 462-64. It is quite true that the court made no finding of reliance *in haec verba.* However, it stated in one portion of its opinion that over the years the directors reposed "trust and confidence" in what defendant told them about the company and did so "in the latter half of 1956 and early 1957." (sic) It further found that it was "elementary economics that information as to an increase in probable sales in any going business is information that is relevant and material to any potential buyer," and that the defendant "knowingly failed to disclose . . . material facts to the Board because their concealment had a tendency to bring about the acceptance by the Board of the offer which he had just submitted." We think it fairly and adequately implicit in the court's findings, in toto, that it found reliance upon the representation.[4]

We turn to the remedy. With respect to damages we draw a distinction between cases where, by fraud, one is

[4] It must be conceded that the court said even less with respect to the plaintiffs who were not directors. However, the court did find that defendant's "offer also was conditioned upon director-shareholders notifying all other shareholders that they themselves had accepted Janigan's offer and recommended its acceptance by all shareholders."

caused to buy something that one would not have bought or would not have bought at that price, and where, by fraud one is induced to convey property to the fraudulent party. In the former case the damages are to be reckoned solely by "the difference between the real value of the property at the date of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to the defendant's conduct, but not damages covering 'the expected fruits of an unrealized speculation.'" *Sigafus* v. *Porter*, 1900, 179 U.S. 116, 125. See *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 10 Cir., 1962, 303 F.2d 527, 533; Securities Exchange Act of 1934, 15 U.S.C. §78bb; 3 Loss, Securities Regulation, p. 1793 (2d ed. 1961).[5] On the other hand, if the property is not bought from, but sold to the fraudulent party, future accretions not foreseeable at the time of the transfer even on the true facts, and hence speculative, are subject to another factor, viz., that they accrued to the fraudulent party. It may, as in the case at bar, be entirely speculative whether, had plaintiffs not sold, the series of fortunate occurrences would have happened in the same way, and to their same profit. However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud, whether foreseeable or not. It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them. See *Marcus* v. *Otis*, 2 Cir., 1948, 168 F.2d 649, 660, 169 F.2d 148. We may accept defendant's position that there was no fiduciary relationship and that he was dealing at arm's length. Nonetheless, it

[5] We note, without more, the broader view suggested in *Rice* v. *Price*, 1960, 340 Mass. 502. Accord, Restatement (2d), Torts §549 (Tent. Draft No. 10, 1964.)

is simple equity that a wrongdoer should disgorge his fraudulent enrichment. *Falk* v. *Hoffman,* 1922, 233 N.Y. 199, 135 N.E. 243 (per Cardozo, J.); 4 Scott, Trusts §§507, 508, 508.1 (2d ed. 1956); Restatement, Restitution §§151, 202, Comments b, c (1937); See *Dickson* v. *Patterson,* 1896, 160 U.S. 584; *cf. Speed* v. *Transamerica Corporation,* D. C.D.Del., 1955, 135 F.Supp. 176, 186-193, *modified on other grounds,* 3 Cir., 1956, 235 F.2d 369; *Kardon* v. *National Gypsum Co.,* D.C.E.D. Pa., 1947, 73 F.Supp. 798, *modified,* 83 F.Supp. 613.

There are, of course, limits to this principle. If an artist acquired paints by fraud and used them in producing a valuable portrait we would not suggest that the defrauded party would be entitled to the portrait, or to the proceeds of its sale. However, those limits are not reached in the case at bar. In answers to interrogatories defendant stated that following the acquisition he did nothing different, and worked no harder than he had before. In his pretrial memorandum he stated that the company's "turnaround" was due to price rises, increased efficiency, and an improvement in the business cycle particularly affecting BESCO's customers. Since defendant received his salary for his personal efforts, which would have been his regular duty, no extraordinary gains in the company's affairs attributable to himself fall within the principle suggested by our artist hypothetical.

There is, however, one exception that we should take note of. The plaintiffs admitted, in fact volunteered, at the hearing on damages that had there been no misrepresentation and no sale the defendant could properly have expected to continue to receive a 10% bonus on net pretax profits under a plan established in 1952, and accepted the figure therefor of $41,567. We agree with the Court's rejection of certain other claims of the defendant as "purely speculative," but we regard such characterization of this

one improper. The burden was on the plaintiffs to show that there would have been a change, and they did not even seek to meet it. This disallowance was unjustified.

We have considered defendant's other points, but do not find them to require comment.

Judgment will be entered remanding the case to the District Court to modify the judgment consistently with the penultimate paragraph of this opinion, but otherwise affirming its judgment. Costs to appellees.